bonding power of the proposed district is far less than any valuation a court could possibly fix. Such an obvious defect makes it hard to believe that the plan is seriously intended to work as advertised. One might say that the plan is cleverly devised so that the lines could be bought only if the courts would allow the Mayor's most extreme claims as to the amount of water in the valuation and would cut the present valuation in two, and this, of course, the courts will not do. Will the Mayor, then, be satisfied merely to keep the matter unsettled while he makes political capital out of the campaign issue thus manufactured? The fact that the companies are not opposing the Mayor's plan lends color to this supposition. A more serious danger is that if his opponents try to outguess him by failing to oppose his plan, or to offer an adequate substitute, both sides may be outguessed and the plan may go through.

J. M. CLARK

UNIVERSITY OF CHICAGO

SOME RECENT FINANCIAL DEVICES

The participating bond is one of the rarest devices in American corporation finance.[1] The Disco Milling Company, an Illinois corporation, is now financing the development of a new flour-milling device through an issue of participating bonds which present certain novel features. The capital required for the purchase of a building and the installation of equipment is to be secured through the sale of $500,000 of twenty-year 6 per cent first-mortgage bonds which carry the privilege of participation in the profits of the corporation on the following basis: 10 per cent of the net earnings of the company is to be set aside for retirement of the principal of the bonds. Whenever the fund so accumulated amounts to $25,000, it is to be applied to the retirement of the principal of the bonds, the face of each bond being reduced pro rata. To facilitate this operation, $50 principal coupons are issued to make up each $1,000 bond. Of the remaining profits, 25 per cent goes to the bondholders and 75 per cent to the stockholders. As no stock is offered to the public, this 75 per cent represents the equity of the inventor, the promoters, and others concerned with the earlier development of the invention, and with its financing. Retirement of part or all of the principal of the bonds

[1] Three cases of its use are cited by Dewing (*Financial Policy of Corporations*, I, 87), all of them obsolete bonds, and no others seem to have been noted by the authors of current financial literature. The writer's attention has been called also to a participating bond issued by McNally-Peck & Company, an Indiana onion producer, four or five years ago, which is still extant.

through the operation of the sinking fund or through maturity does not affect the participation, each bondholder continuing to draw his proportion of the net earnings until 1981. In order to avoid the danger of this participation being treated by the courts or the administrators of the Blue Sky laws as really a distribution of bonus stock, a trustee is interposed between the company and the bondholders. Title to the property is held for the bondholders by the trustee, a reputable trust company, and the property is leased to the operating company. The interest, sinking fund, and share of profits are all due to the trustee as rent. This, it will be noted, makes the claim of the bondholders to their share of undistributed profits a creditor's lien.

Another new financing device is the ten-year convertible first-mortgage 9 per cent bond issued by the Rio Blanco Syndicate, Incorporated, of Colorado, to finance the development of a project for extracting oil from shale. The novel feature of this bond is the provision that the 9 per cent interest is due and payable only on the date of maturity of the bond. The conversion privilege consists of a right to convert each $100 bond into $400 par value stock of the corporation "at such time prior to its maturity as said conversion may be offered by the Syndicate." The Syndicate agrees to make such offer at some date prior to the maturity of the bond. Apparently, however, there is no limitation on the amount of stock which may be issued, so that the actual proportion of the profits accruing to the holders of $400 of stock is left to the discretion of the management.

Another device for raising capital which has been in use for some years, but seems to have escaped the attention of financial writers is the certificate of beneficial interest in oil leases held by a trustee. The plan of operation is as follows: An individual promoter or a small group buys either the leases on properties more or less remote from oil production, or a share of the one-eighth royalty interest which under the standard type of oil leases is reserved to the landowner. These leases are then assigned to a trustee, in small deals usually one of the promoters, and certificates of beneficial interest, representing small fractions of the equity, are sold to speculative investors. The total interest covered by the deed of trust varies from a single quarter-section to a consolidated royalty interest in thousands of acres, with a corresponding variation in the number of shares. The financial principle is that title to property of unknown value can usually be sold in small fractions for a much greater amount than it can be sold for in block. Not infrequently 1 per cent interests in a lease are sold for about one-

fiftieth the cost of the lease to the promoters, but there is no standard rate of profit in this type of transaction. As one promoter puts it, "If there is oil there, the lease is worth more than we can possibly get for it; if there is none there, it isn't worth anything. So any price we can get is a fair price." No financial obligations are assumed by the certificate-holders or the trustee, except office expenses and rentals due under the lease. If the syndicate holds an interest in a lease, annual rentals will be due to the landowner; if the holding is an interest in the landowner's royalty, the rentals will be a source of income to the syndicate. If the holding is a lease the trustee is empowered to sell out to an operating company or to negotiate a contract for drilling out the property on a royalty basis. Normally, such a contract cannot, of course, be secured at the outset, but if the prospects are improved by wells being brought in near by, it becomes possible to secure a contract to have a well drilled on a basis which leaves the syndicate an equity of one-eighth or one-fourth. In case the operators are successful, either in selling out the holding or in securing a drilling contract which results in a discovery of oil, the duties of the trustee are simple, consisting merely of the collection of the proceeds and their distribution to the stockholders. In case the lease gets a black eye through the drilling of dry holes near by, or in case drilling operations are unsuccessful, the duties of the trustee are still further simplified. Where the syndicate holds a royalty interest in the farmer's reserved eighth in property on which the leases are held by operating companies, the trustee has no duties until a well is brought in by the lessee; then he collects and distributes the royalty. Certificates of beneficial interest in these "trusts" are transferable, and are freely bought and sold.

The possible bearing of recent Blue Sky legislation on the development of financial devices is noticeable. There is as yet no uniform body of rules or decisions interpreting the Blue Sky laws, but in various states it has been held that certificates of participation in a trust are not securities within the meaning of the law and that first mortgage bonds on real estate are not speculative securities. The advantage of utilizing these financial devices for speculative projects are obviously increased by this circumstance.

Charles O. Hardy

University of Chicago